

Detained In Myanmar


Energy & Environment

Brexit

North Korea

Charged: The Future of Autos

Futur



See what a financial
advisor can do for you.

[Learn More](#)**RAYMOND JAMES**

LIFE WELL PLANNED.

FINTECH

OCTOBER 18, 2017 / 6:06 PM / 8 MONTHS AGO

Special Report: Backroom battle imperils \$230 million cryptocurrency venture

Anna Irrera, Steve Stecklow, Brenna Hughes Neghaiwi



ZUG, Switzerland/NEW YORK (Reuters) - Just three months ago, a tech project called Tezos raised \$232 million online in a wildly successful “initial coin offering,” in which new digital currency is parceled out to buyers. At the time, it was the most money ever raised from the public in the white-hot cryptocurrency sector.

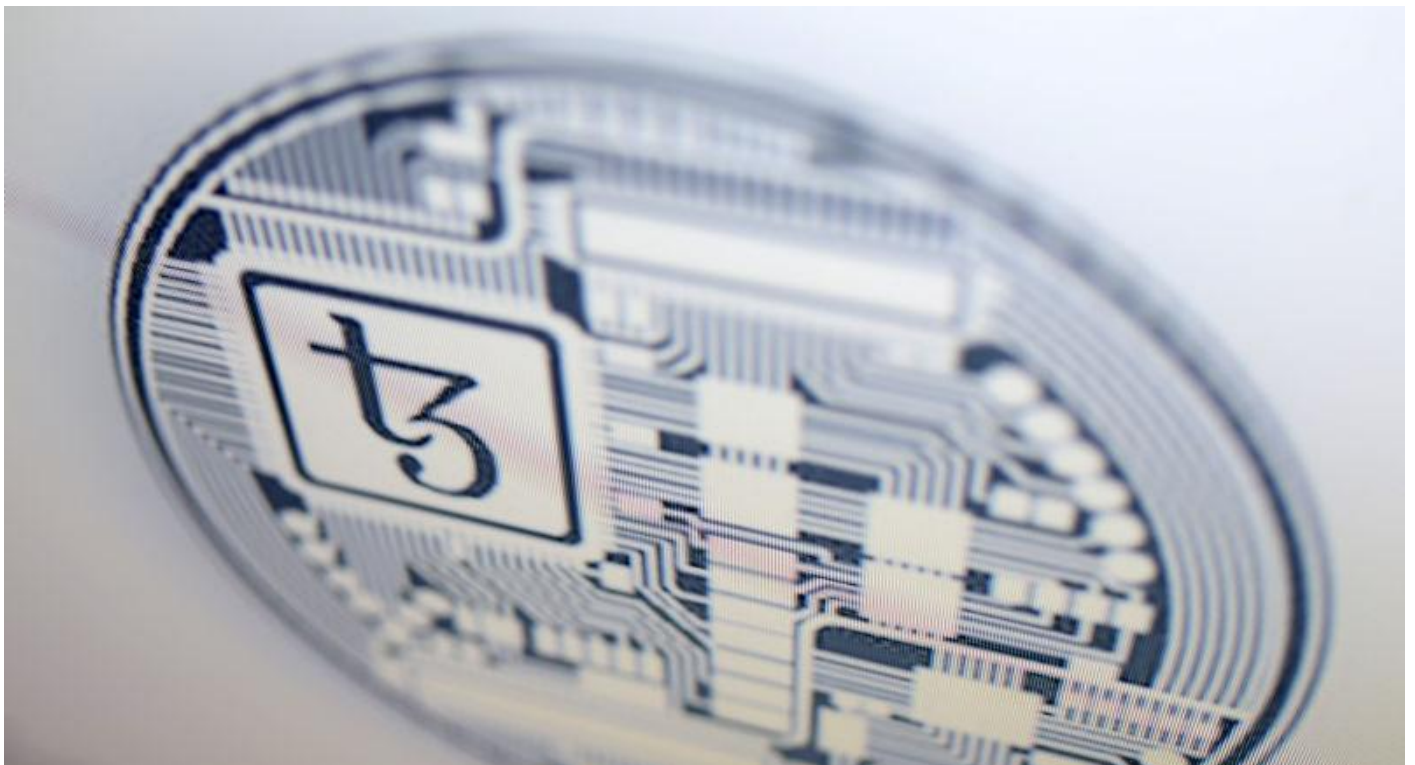




Photo illustration shows detail of Tezos website, October 10, 2017. Picture taken October 10, 2017.
REUTERS/Dado Ruvic/Illustration

But the venture is now in danger of falling apart because of a battle for control playing out behind the scenes, Reuters has learned.

The acrimonious dispute pits Tezos' two young founders – Arthur and Kathleen Breitman – against Johann Gevers, the president of a Swiss foundation the couple helped establish to handle the coin offering and promote and develop the Tezos computer network.

Under Swiss law, the foundation is supposed to be independent. It holds all of the funds raised, which have mushroomed to more than \$400 million in value because the contributions were made in two cryptocurrencies – bitcoin and ether – that have appreciated sharply. But the Breitmans, who still control the Tezos source code through a Delaware company, are seeking to oust the head of the foundation.

An attorney for the Breitmans sent a 46-page letter on Sunday to the two other members of the foundation's three-person board, calling for Gevers' prompt removal and seeking to give the couple a "substantial role" in a new structure that would limit the foundation's responsibilities. The document accuses Gevers of "self-dealing, self-promotion and conflicts of interest." According to Gevers, the two board members later suggested via email that he step aside for a month while they investigate.

Gevers told Reuters he is not stepping down. "As Arthur has done to others before me," Gevers said, "this is attempted character assassination. It's a long laundry list of misleading statements and outright lies." He said the other two board members "are attempting an illegal coup."

The Breitmans have been trying to control the foundation as if it were their own private entity, Gevers said, by bypassing the foundation's legal structure and interfering with management

and operations. This has resulted in costly delays in developing and launching the Tezos network and new currency, he said.

“They’re unnecessarily putting the project at risk,” he said.

In a written statement sent to Reuters, the Breitmans reiterated their accusations against Gevers and said they acted “in accordance with all applicable laws and regulations.” They said their priority “remains the successful launch of the Tezos network.”

Hundreds of millions of dollars are at stake: The Tezos digital coins, called “Tezzies,” are already priced at a hefty premium in futures trading even though they don’t yet exist. The launching of the Tezos network, which will trigger the coins’ release, has been delayed. Until the network launches – and no date is set – contributors to the fundraiser will receive nothing.

Under the terms of the Tezos coin offering, there’s no guarantee participants will ever receive a single Tez. Participants agreed to accept the risk that the project “may be abandoned.” Despite the feud, Gevers said he remains committed to resolving the feud so that “this project succeeds.”

The tale of how two young entrepreneurs raised a fortune for a project barely out of the starting blocks is reported here in detail for the first time. It highlights the risks inherent in the current frenzy for ICOs, in which tech startups issue new cryptocurrencies to raise capital.

Reuters reported last month that cryptocurrency exchanges – where virtual currencies are bought, sold and stored – have become magnets for fraud and deception. More than 980,000 bitcoins – the most popular virtual currency – have been stolen since 2011. Today they would be worth about \$5 billion.

Similar large sums are pouring into initial coin offerings. From January through September, ICOs generated \$2.2 billion, more than three times the amount invested in similar startups by traditional venture capital firms, according to Novum Insights, a data provider.

ICOs can be a way for technology projects to raise money online to finance the development of new, open-source computer networks that aren’t necessarily looking to make a profit.

Contributors receive new digital coins, or tokens, which they typically need to “pay” to access the new networks.

But the recent flurry of ICOs raising millions of dollars has attracted some dubious business propositions and outright scams, as well as speculators looking to trade the coins for swift gains. Authorities in the United States, Switzerland, China, Singapore and other nations have begun scrutinizing the sector closely for potentially tougher regulation.

“Most ICOs are bought by people looking to ‘flip’ their tokens to a greater fool for a quick profit,” said Alistair Milne, a co-founder of the London-based Altana Digital Currency Fund, which so far has avoided ICOs. More than “90 percent will fall to have a near-zero value in time,” he predicted.

The new cryptocurrencies function through a technology called blockchain, essentially a public ledger maintained by a network of computers. Blockchain applications are being tested by financial services firms, food suppliers, retailers and other businesses as a way to make record-keeping simpler and cheaper. Tezos aims to be a blockchain that’s more reliable than the ones behind bitcoin and ether. Several entrepreneurs and investors in the blockchain industry said the Tezos technology has potential because it would be easier to upgrade and may be more secure than other blockchains.

Top 10 Initial Coin Offerings

Large sums are pouring into ICOs as blockchain ventures raise capital by creating and distributing new cryptocurrencies.

Name	Date	Raised* (\$)	Registration country
EOS	June 2017-ongoing	289,000,000 (Estimate)	Cayman Islands
Filecoin	August-September, 2017	233,000,000	USA
Tezos	July 2017	232,319,985	Switzerland
Bancor Protocol	June 2017	153,000,000	Switzerland
Kik	August/September, 2017	100,000,000	Canada
Status	June 2017	95,000,000	Switzerland
TenX	June 2017	83,110,000	Singapore
Press.One	July 2017	82,000,000	China
KyberNetwork	September 2017	50,000,000	Singapore
MobileGo	April/May 2017	53,069,235	USA

*Figures may include amount raised in pre-sales.

Note: Amounts raised may have changed since the ICOs concluded as contributions are typically made in other cryptocurrencies whose values fluctuate.

Source: Novum Insights

ANARCHO-CAPITALISM

The son of Jean-Claude Deret, a French playwright and actor, Arthur Breitman studied applied mathematics, computer science and physics in France, before moving to the United States and studying financial mathematics at New York University. He went on to work for the investment banks Goldman Sachs and Morgan Stanley.

He is still listed as a co-organizer and “dear leader” for the New York Anarcho-Capitalist Meetup in New York, which describes its philosophy as “a type of radical libertarianism that favors the abundant wealth production, rapid technological development, and high standards of living produced by capitalism.” Its website adds, “We are also fairly lazy about fighting the state.”

It was at a crypto-anarchist lunch in 2010 that Breitman first met Kathleen McCaffrey, an American college student from New Jersey. She is described on a political blog called The

Politicizer as a libertarian Republican who first became interested in politics after listening to the provocative radio personality Rush Limbaugh at the age of five. She married Breitman in 2013.

Kathleen Breitman, now 27, later worked at the hedge fund Bridgewater Associates and at R3, a blockchain company. In a July post on the conservative website legalinsurrection.com, she said she “didn’t get along” at the hedge fund but had “a great time” at R3.

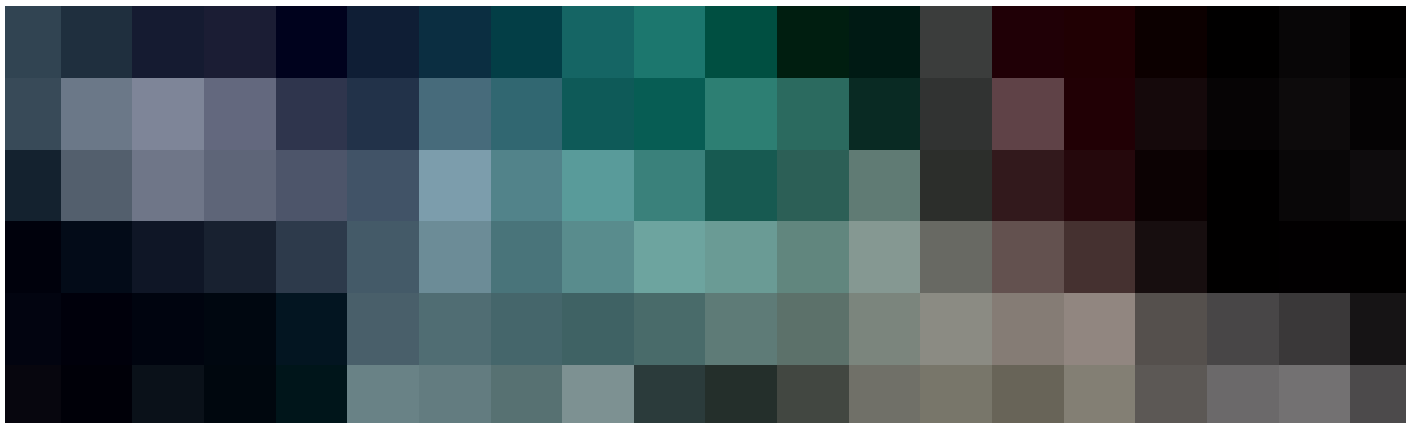
Bridgewater didn’t respond to a request for comment.

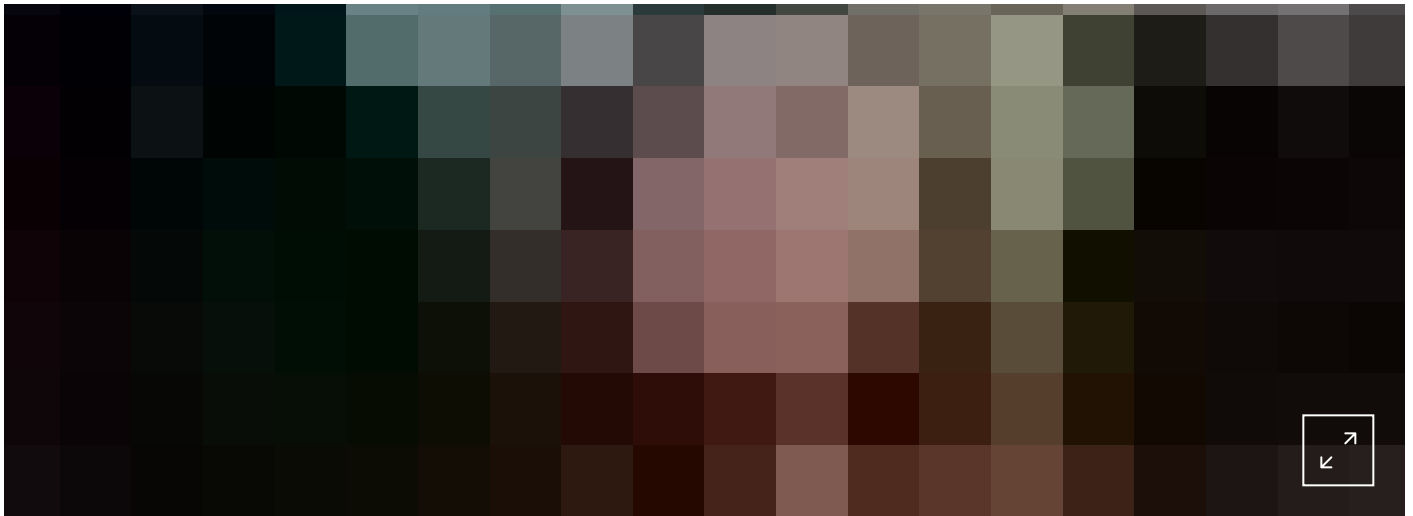
Arthur Breitman, 35, was an early fan of bitcoin, which first appeared around 2009. But he came to believe there were flaws in the blockchains behind bitcoin and other cryptocurrencies, finding them hard to upgrade and not secure. He tried to come up with something better.

In the summer of 2014, while working at Morgan Stanley in quantitative finance, Breitman released two papers online that presented his concept for a new type of blockchain. He called it Tezos, a name his wife has said he coined after creating an algorithm that searched for the names of unclaimed websites pronounceable in English.

The papers were published under a pseudonym, “L. M Goodman,” but emails and messages from Arthur Breitman reviewed by Reuters make it clear he was the author.

In an email Breitman sent to an acquaintance in early 2015, he said he was seeking to create a business based on Tezos but was trying not to be associated publicly with the project at the time. He expressed worry that his activities might conflict with his employment at Morgan Stanley, messages show.





Kathleen Breitman, co-founder & CEO of Tezos, participates in the panel discussion "Creating \$200 Million Out of the Ether" at the 2017 Forbes Under 30 Summit in Boston, Massachusetts, U.S., October 2, 2017. REUTERS/Brian Snyder

Reuters reviewed a copy of a "Tezos Business Plan" from early 2015, which listed Breitman as chief executive. The plan projected that if the company survived 15 years, it would be worth between \$2 billion and \$20 billion. The budget called for paying Breitman \$212,180 in salary by year three. In August 2015, Breitman, who was still working at Morgan Stanley, set up a company in Delaware called Dynamic Ledger Solutions Inc, or DLS, to develop Tezos. He listed himself as chief executive.

The U.S. Financial Industry Regulatory Authority (FINRA) requires registered securities professionals to provide prior written notice to their employer to conduct outside business activities if there is "reasonable expectation of compensation." According to FINRA records, Breitman was registered and did not report any "other business activities." Morgan Stanley and FINRA declined to comment.

"We made all the proper disclosures," Kathleen Breitman told Reuters in June. "It was a hobby, you know. And like there was never any intention to really commercialize any of the software." She added: "We had some meetings with like C-suite executives at banks ... but honestly nothing serious."

"A TERRIBLE SALESMAN"

In 2015, Arthur Breitman was pitching “Tezos Inc.” in the hope of creating a consortium of four to five banks to adopt the technology and fund the operation. The business plan reviewed by Reuters called for raising \$5 million to \$10 million over two to three years.

By then, blockchain was beginning to pique the interest of large financial institutions for its potential to help cut costs of cumbersome back-office processes, such as the clearing and settlement of securities trades. Tezos’ 37-page business plan called it “an Internet for financial transactions” and said the technology could be used to automate the over-the-counter derivatives trading market.

But Breitman failed to attract backers. He told Reuters in June that he blamed his fundraising failures on the decision to develop the technology first, rather than just selling “a dream” as other blockchain startups were doing.

“I guess I was a terrible salesman as well,” he said.

“I can speak to that,” his wife said.

In April 2016, Arthur left Morgan Stanley, and by that September, the Breitmans had started working on a new strategy for Tezos – to conduct an online fundraiser to distribute digital tokens, whose holders would maintain the Tezos blockchain. But the couple needed funds to keep the project going.

Over the next six months, they received \$612,000 from 10 early backers, including several cryptocurrency hedge funds, according to the Tezos.com website.

To conduct the ICO, the Breitmans chose a complex structure. Earlier this year, they helped to create a foundation based in Zug, Switzerland – dubbed “Crypto Valley” because of its many blockchain startups – that is seeking not-for-profit status, emails show. The idea, according to documents on the Tezos website, was that the foundation would raise money via the ICO, then acquire DLS, the Breitman-controlled company that has been developing Tezos.

Working through a Swiss foundation, the Breitmans thought, would provide regulatory oversight but not too much. Kathleen Breitman told Reuters in June that she and her husband

opted to use a foundation based in Zug because Switzerland has “a regulatory authority that had a sufficient amount of oversight but not like anything too crazy.”

Georg von Schnurbein, co-author of a book on Swiss foundation governance, expressed surprise over cryptocurrency ventures like Tezos setting up not-for-profit foundations in Switzerland. “For me, the public interest is not clear,” he said. While not illegal, he said, creating a foundation with the aim of allowing inventors to profit from a sale conflicted with its status as a not-for-profit, which is supposed to benefit the public. He said federal regulators eventually might prohibit it.

“The issue that there is some kind of for-profit entity and there are transfers right at the beginning is something that is working at the moment, but won’t be sustainable,” he said.

“EXAGGERATED, TO SAY THE LEAST”

As work continued for the ICO, which was originally scheduled to be held in May, the project started running out of cash, Kathleen Breitman told Reuters. She spoke with Tim Draper, the well-known founding partner of Silicon Valley venture capital firm DFJ and a staunch bitcoin supporter. He invested \$1.5 million through his firm, Draper Associates, which included taking a minority stake in DLS, the company that controls the Tezos source code.

The Breitmans had also hired Strange Brew Strategies, a U.S. communications company, to promote their project, and Reuters wrote a news story on May 5 about Draper’s involvement.

In pitching the story to Reuters, John O’Brien, a principal of Strange Brew, had made claims about Tezos’ progress. He wrote: “The applications of Tezos, ranging from derivatives settlement to micro-insurance, are real and recognized by industry giants. Ernst & Young, Deloitte, LexiFi, etc. have adopted Tezos in their development environments and labs.”

On Oct. 3, a spokeswoman for the accounting firm Ernst & Young told Reuters: “The statement is not correct. EY has not adopted Tezos.” A spokesman for Deloitte said Tezos’ code is “one of many technologies we’re considering” with blockchain, but it’s “still early stage and we haven’t used the technology for a client project.”

Jean-Marc Eber, CEO of the French software company LexiFi, said, “The sentence, as stated, isn’t accurate and unfortunately exaggerated, to say the least.” While there had been “informal contacts,” he said, “at this stage, LexiFi has not adopted Tezos’ technology in its development environment or labs.”

Strange Brew declined to answer questions about the statement.

INVESTMENT OR DONATION?

The Tezos fundraiser began on July 1. The Breitmans had wide-ranging expectations about how much they might raise. A document on Tezos.com suggested that if they received more than \$20 million, they might use it to “negotiate with a small nation-state” to adopt Tezzies, or acquire mainstream print and TV media outlets to promote the technology. In June, Kathleen Breitman told Reuters that about a year ago, when the price of bitcoin was lower, “we were like, ‘Hey, we would be lucky if we get 20 million.’”

When it ended after 13 days, the project received about 66,000 bitcoins and 361,000 ethers, worth about \$232 million at the time. The hoard is now worth about twice that.

Kathleen Breitman told Reuters that participating in the Tezos fundraiser was like contributing to a public television station and receiving “a tote bag” in return. “That’s kind of the same thing here,” she said.

The fundraiser’s terms called the contributions “a non-refundable donation” and not a “speculative investment.”

If deemed a donation, and not a security, the funds raised might not fall under the remit of financial regulators in the United States. In the U.S., investments in assets such as company shares and other securities are regulated by the Securities and Exchange Commission. The SEC has been studying ICOs, and in July issued an investor bulletin that warned: “Depending on the facts and circumstances of each individual ICO, the virtual coins or tokens that are offered or sold may be securities.”

Part of the SEC's assessment is to examine the reasonable expectations of participants in the ICO. Some participants in the Tezos fundraiser told Reuters they viewed the coins at least partly as an investment.

Kevin Zhou, co-founder of the cryptocurrency trading fund Galois Capital, said he invested about five bitcoins in Tezos, which he considers overall one of the better ICOs.

"For me and for a lot of people this is an investment. We are looking for a return," Zhou said. "I don't really care about" using the Tezos technology, he added.

Draper told Reuters that cryptocurrencies are commodities like pork bellies, and characterized acquiring Tezzies as a purchase rather than a donation. Asked this month how much he donated during the Tezos fundraiser, he replied via email, "You mean how much I bought? A lot."



Slideshow (9 Images)

“TOTAL MENSCH”

At the moment, the Tezos Foundation holds all of the fundraising proceeds, while the Breitmans, through their Delaware company, control much of Tezos’ intellectual property. The plan is for the foundation to acquire the Breitmans’ company and release the technology under a free software license, according a “Transparency Memo” on the Tezos website.

Gevers, who founded the Tezos Foundation, said it has a contract that stipulates the Breitmans will either sell the Delaware company to the foundation “within a reasonable point of time” or, if they don’t, “the foundation can take it.” He declined to provide a copy of the contract.

When the foundation will acquire the Breitmans’ company remains unclear. Kathleen Breitman told Reuters in June, “Essentially, you know, they’re going to buy out the company in like July or so, I guess.”

The Breitmans stand to receive millions of dollars if the deal goes through. According to the “Transparency Memo,” the new blockchain “must launch and operate successfully” for three months, then DLS’s shareholders – the Breitmans and Draper – are entitled to receive 8.5 percent of the fundraiser proceeds in cash. That amount, according to Gevers, is about \$19.7 million. The shareholders also are slated to receive another 10 percent of the Tezzies issued, with the coin distribution spread out over four years. Those coins currently are worth about \$140 million in futures trading.

Prior to the fundraiser, Kathleen Breitman effused about Gevers, 52, a Zug-based South African entrepreneur who has never before run a foundation. During an “Ask Me Anything” session in May on an online chat channel, she posted: “He’s awesome. Total mensch and very philosophically committed to our project.”

Relations later soured. The Breitmans objected to people the foundation suggested it wanted to hire, Gevers said. Another sticking point: The couple’s company hasn’t relinquished control over the foundation’s own website, www.tezos.ch.

“They control the foundation’s domains, websites and email servers, so the foundation has no control or confidentiality in its own communications,” Gevers said.

The Breitmans officially have no role at the Tezos Foundation. The letter from their lawyer this week proposed the creation of two foundation subsidiaries – Tezos AG and Tezos France SA – to develop and support Tezos, with the Breitmans serving as chief executive and chief technology officer of Tezos AG. The couple also would be given “observer status” on the foundation board. The foundation would then “limit” its activities to supervising and supporting the subsidiaries, “rather than conducting any direct operations.”

According to von Schnurbein, under Swiss law “the foundation is completely independent and the foundation board is completely independent.” Gevers said the foundation wants the couple to continue playing a leading advisory role. “They are both very competent people and obviously they started this whole thing. And it would be stupid to exclude them.”

But he added: “You can rest assured as long as I have anything to do with this, the foundation will be independent.”

Gevers said he has filed a complaint with Swiss regulators about the request he received via email this week from the foundation’s two other board members that he step down from the board for a month. A spokesman for Switzerland’s Federal Department of Home Affairs, which oversees the agency that supervises foundations, told Reuters that asking a board member to step aside must be done at a board meeting, not via email. The two board members who emailed Gevers didn’t respond to a request for comment.

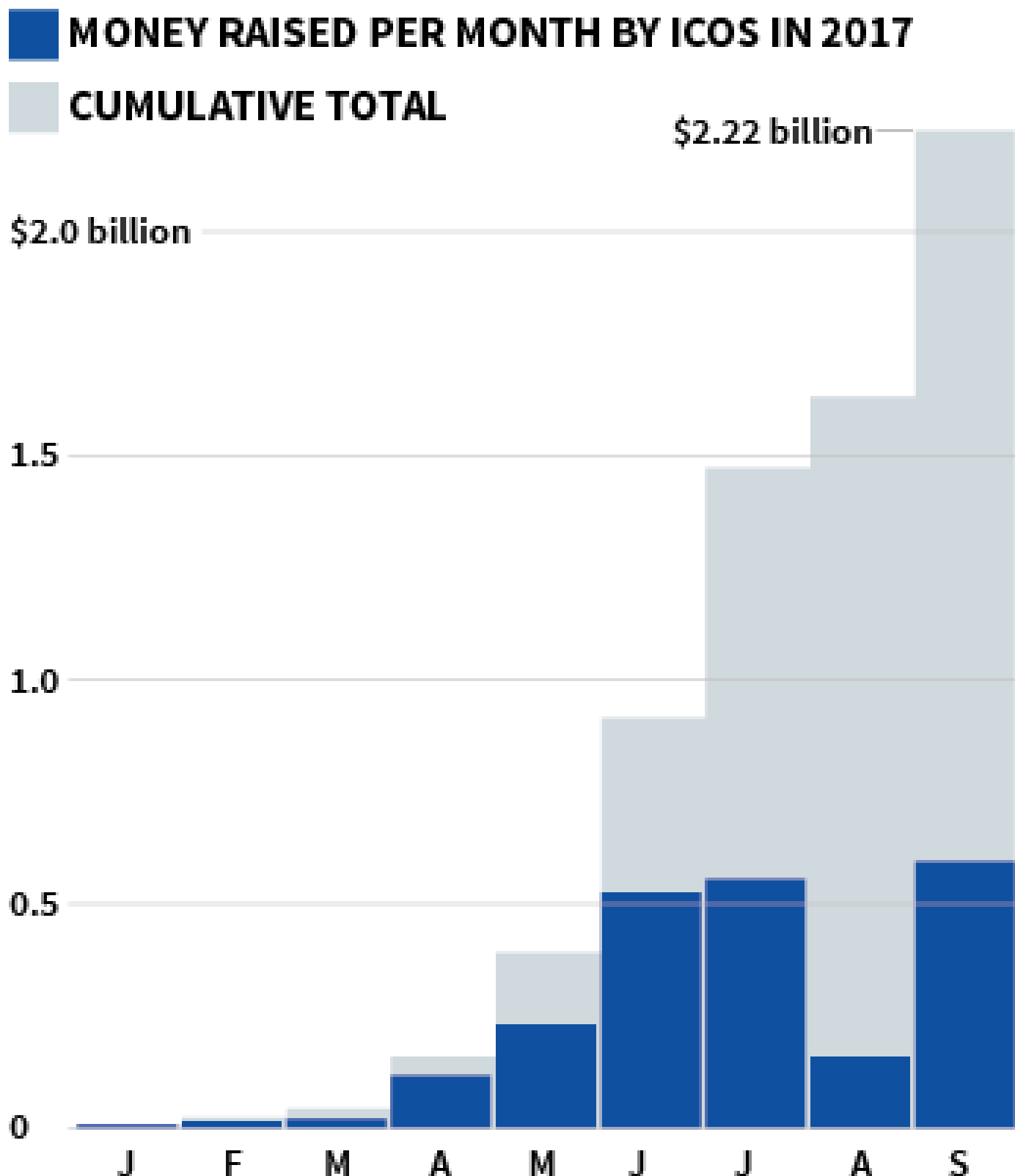
As for the hundreds of millions of dollars’ worth of cryptocurrencies raised in the ICO, Gevers said the foundation has slowly begun selling the virtual currencies – lately about \$10.2 million worth a week – and plans to invest the proceeds in a diverse portfolio. The funds are intended to be used to run the foundation, ensure Tezos works and help to develop products using the technology.

So where are all the bitcoins and ethers raised in the ICO stored? That, Gevers said, was confidential.

“These are not held in any one place,” he said, “but secured through high-security” digital wallets “that no single party has control over.”

ICO Frenzy

Initial Coin Offerings have raised record amounts this year.



Source: Novum Insights

Anna Irrera reported from New York, Steve Stecklow from London and Zug, and Brenna Hughes Neghaiwi from Zug; Additional reporting by Jemima Kelly in London; Editing by Richard Woods and Michael Williams

Our Standards: [The Thomson Reuters Trust Principles.](#)

[Apps](#) [Newsletters](#) [Advertise with Us](#) [Advertising Guidelines](#) [Cookies](#) [Terms of Use](#) [Privacy](#)



All quotes delayed a minimum of 15 minutes. See [here](#) for a complete list of exchanges and delays.

© 2018 Reuters. All Rights Reserved.